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The impact of the Novel Coronavirus on the Construction Sector

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As of 19 February 2020, the novel coronavirus (2019-nCoV, the "**Coronavirus**") has affected 28 countries and regions according to publicly available information. As an emergency response to the outbreak of the Coronavirus, Chinese national and local regulators have adopted various measures to minimize and control the movement of persons to prevent the further spread of the epidemic but these measures have caused the suspension of work across large swathes of the economy.

The stoppage is likely to be particularly acute in the construction and infrastructure sectors, which normally mobilise large quantities of labour. As a consequence, Chinese contractors are already becoming less competitive in the market with concerns increasing as to their capability and capacity to undertake international projects.

Whether the outbreak of the Coronavirus amounts to an event of *force majeure* or change of circumstance under the common law and the PRC law (such that a contracting party may avoid liability in respect of the performance of its obligations), may be informed by the regulations and court decisions promulgated around the time of the Severe Acute Respiratory Syndrome, or ("**SARS**"). In this note, we will also discuss the impact of the Coronavirus for both overseas and domestic construction projects, as well as recommendations for contractors involved in those projects.

We look at two possible claims arising out of the outbreak: the first for '*force majeure*' and the second for 'change of circumstance' under PRC law.

The Coronavirus may constitute '*force majeure*' under PRC law

The "*Notice of the Supreme People's Court on Conducting the Trial and Enforcement of the People's Court in the Period of the Prevention and Control of Infectious Atypical Pneumonia*" (《最高人民法院关于在防治传染性非典型肺炎期间依法做好人民法院相关审判、执行工作的通知》(Fa [2003] No. 72, (the "**Notice**") may provide some guidance.

Article 3 of the Notice provides that "*...disputes caused by the government and relevant departments' administrative measures to prevent the SARS epidemic that directly result in the contract being unable to be performed, or due to the impact of the SARS epidemic, the parties to the contract being unable to perform at all, should be dealt properly in accordance with the provisions of Articles 117 and 118 of the 'Contract Law.'*" (provisions that deal with *force majeure*). Although this regulation has now expired, since the epidemic prevention and control measures taken by Chinese regulators due to the Coronavirus are not easily foreseeable,

avoidable, or surmountable, these measures may be considered to give rise to *force majeure* circumstances by analogy.

This interpretation has been confirmed in the recent civil judgment by the Supreme People's Court in *Zui Gao Fa Min Zai* No. 220, which agreed with the first and second instance courts that SARS was indeed an event of *force majeure*. Similarly, the Sanya Intermediate People's Court in its civil judgment ((2005) *Sanya Min Yi Zhong Zi* No. 79), concluded that the ban issued by the Sanya City government during the SARS period that prohibited construction companies from hiring foreign migrant workers had been the cause of the contractor's failure to recruit sufficient engineering staff to complete construction contracts entered into prior to the ban. Therefore, the SARS epidemic constituted '*force majeure*', relieving the contracting party of liability for delay and the breach of its obligations under the relevant contracts.

Similarly, on 10 February 2020, the spokesman of the Commission of Legislative Affairs of the National People's Congress, in response to public queries, explained that "*...the type of epidemic prevention and control measures taken by local governmental departments that make a party unable to perform its obligations constitutes a force majeure event, being one which is unforeseeable, unavoidable and insurmountable. According to the PRC Contract Law, if a contract cannot be performed due to force majeure, liability can be partially or wholly excused depending on the extent of influence of force majeure, except as otherwise provided by law.*"

Given that a majority of cities in Hubei province are the subject of a lockdown and that other provinces have largely extended the holiday (with quarantining and remote working becoming the norm thereafter), we can expect that a lack of human resources and a delay to the milestones of construction projects will continue for some time.

If the epidemic prevention and control measures undertaken by national and local governmental departments do result in a late return of construction personnel to project sites, progress may also be impacted by shortages of materials or mandatory quarantine affecting the sites. These circumstances are likely to be regarded as *force majeure* events. In addition, Article 17.1 of the Construction Engineering Contracts (Model Text) (GF-2017-0201, "Construction Model Contract, "建设工程施工合同（示范文本）) has expressly listed "epidemic" as one of the acknowledged *force majeure* events.

That being said, in order for *force majeure* to excuse liability, the contracting party needs to prove that (i) the contract was signed prior to the outbreak of the Coronavirus; (ii) the *force majeure* event was incurred in the course of performance; (iii) the outbreak was the cause of the non-performance; and that (iv) the party claiming *force majeure* had conducted mitigating measures to limit the loss to the counterparty, providing timely notice and proof.

Although the control measures may be considered as a *force majeure* event under certain circumstances, if the contract can still be performed and the only impact would be on a party's financial standing (perhaps because the contract becomes more costly to perform), the affected party can be required to perform its obligations under the contract.

The Coronavirus may constitute a 'change of circumstance' under the PRC law

Article 26 of *the Interpretation on Certain Issues Concerning the Application of the Contract Law (II)* (Fa Shi [2009] No. 5, 《最高人民法院关于适用<中华人民共和国合同法>若干问题的解释（二）》（法释[2009]5 号) issued by the Supreme People's Court on 24 April 2009 introduced the concept of 'change of circumstance,' which provides that "*… [where there are] significant changes that could not be foreseen by the parties at the time of conclusion of the contract, and such changes are not caused by force majeure and do not constitute commercial risks, and where continuance of performance will be obviously unfair to one of the parties or will not*

achieve the purposes for which the contract was concluded, the people's court shall, upon request by a concerned party, determine whether the contract should be modified or terminated on the basis of the principle of fairness and by considering the actual situation prevalent in the case. "

In contrast with the assertion of a *force majeure* event which the courts may apply on their own initiative, 'change of circumstance' has to be claimed by one of the parties in dispute. The Supreme People's Court adopts a more conservative and prudent standpoint when applying the 'change of circumstance' provision[1]. In addition, the application of the provision will also grant more discretion to the local people's court to either modify or terminate the contract on the basis of the principle of fairness and by considering the actual situation on the ground.

The main factors considered by the local people's court when determining whether or not there has been a change of circumstance include: (i) has there been a significant change to the circumstances prevailing at the time the contract was signed, when viewed objectively; (ii) has the change of circumstance occurred after the conclusion of the contract and before the fulfilment of the obligations due under it; (iii) could the change of circumstance have been foreseen when the contract was concluded; (iv) can the change of circumstance be attributed to both parties; and (v) would it be obviously unfair to oblige the party to continue to perform the contract or will performance not achieve the purposes for which the contract was concluded?

The major difference between the *force majeure* and the change of circumstance provisions is that a contract cannot be performed under while *force majeure* persists, whilst a contract can still be performed under a change of circumstance. The PRC Courts, when applying *force majeure,* will usually excuse the liabilities and obligations of the parties.

When applying the change of circumstance, on the other hand, the courts will often amend the parties' obligations under the contracts to ensure fairness between the parties. Therefore, for contracts that can still be performed objectively, parties may not claim '*force majeure*' but instead may claim 'a change of circumstance' if continuous performance of the contract will be obviously unfair to one of the parties or will make it more difficult for the purpose of the contract to be achieved.

Consequences of the Coronavirus outbreak on domestic construction projects

a. Delay of construction period and implications for liability and cost

As discussed above, cessation of work because of the public health measures will inevitably delay progress. For example, apart from the measures taken by the Ministry of Human Resources and Social Security and its local offices, some provincial bureaus (such as those in Shanxi Province and Henan Province) of the Ministry of Housing and Urban-Rural Development ("**MOHURD**") now even require that work on construction projects cannot be resumed without their approval.

While the assertion of *force majeure* may apply under PRC law to excuse liability, parties still face losses caused by the work stoppage. In this regard, parties may refer to the 2013 Specifications of Pricing of Bill of Quantity in Construction Projects ("BOQ Pricing Specification," 2013 建设工程工程量清单计价规范) and the Construction Model Contract published by the MOHURD if the contract in question adopts the language of the model contracts.

Pursuant to Article 17.3.2 (4) of the Construction Model Contract, if a *force majeure* event causes a delay in the construction period, the construction period should be extended accordingly and

[1] Notice of the Supreme People's Court on Correctly Applying the Interpretation II of Several Issues concerning the Contract Law So As to Serve the Primary Objectives of the Party and the State (No. 165 [2009] of the Supreme People's Court, 《最高人民法院关于正确适用《中华人民共和国合同法》若干问题的解释(二)服务党和国家的工作大局的通知》)

the contractor's losses should be reasonably shared between the employer and the contractor. The salaries of engineering staff during the downtime must be borne by the employer. In addition, clause 9.10.1(4) of the BOQ Pricing Specification states that the expenses for managers and security personnel to stay on the construction site during the downtime, if so requested by the employer, should also be borne by the employer.

Once the *force majeure* event has come to an end and the contractor resumes work, the construction period should be extended accordingly. If the employer requires the contractor to expedite the work, then the cost should be borne by the employer. Clause 17.2 of General Model Contract of Construction Project (trial version) (GF-2011-0216, 《建设项目工程总承包合同示范文本（试行）》) provides that the employer should bear its losses resulting from the cessation of work caused by the *force majeure* event.

b. Increases of cost of equipment and materials

Emergency measures being adopted by local government departments may cause cost increases in equipment and materials because of supply constraints, such as problems with logistics or the local hoarding of stock. Pursuant to the *Measures for the Administration of General Contracting of Housing Construction and Municipal Infrastructure Projects*, jointly issued by the MOHURD and the National Development and Reform Commission on 23 December 2019 (which will take effect on 1 March 2020), the employer must shoulder increased construction costs caused by a *force majeure* event. The employer generally needs to bear increased costs in materials, equipment and labour that have come about between the bidding period and the performance period if the cost increases exceed that which has been stipulated in the contracts.

Implications of the Coronavirus on commercial contracts under English and Hong Kong law

Common law jurisdictions have similar concepts to *force majeure* and the change of circumstance under PRC law. However, the courts usually seek to enforce performance of a contract and will be slow to accept that external events, no matter how serious or extreme, should excuse a party from fulfilling its obligations.

The intention of '*force majeure*' is to excuse one or both parties from performance of the contract following certain events. Whether the Coronavirus would constitute such an event will depend on the exact wording of the clause itself.

First, does the '*force majeure*' clause cover a crisis or epidemic? A clause may cover events beyond a party's 'reasonable control', but a court may find the wording too general to be enforceable. The clause must indicate that the parties anticipated the event and made specific provision for it.

Second, how does the clause actually operate? If it talks about the 'prevention' of performance (as opposed to hindrance or delay), then the party seeking to rely on the clause has to show that it has become impossible to perform the obligation, not simply that it has become more difficult or costly.

It is vital to consider the precise wording of the clause in the contract. The fact that the region has previously been buffeted by viral outbreaks such as SARS, means that courts may take the view that businesses should have had the foresight to make specific provision in their contracts for exceptional events of this nature.

Where the contract contains no *force majeure* clause, a party may seek to take advantage of the common law doctrine of 'frustration'. A contract may be frustrated where a significant change of circumstances makes performance radically different from the obligations undertaken originally.

Again, the courts are reluctant to find that frustration exists, and the fact that something has happened to make performance more onerous or expensive, is unlikely to persuade the courts to excuse performance.

In view of the fact that the World Health Organisation on 30 January 2020 declared the outbreak of the Coronavirus to be a Public Health Emergency of International Concern ("**PHEIC**"), a party's claim for *force majeure* may be successful, depending on the wording of the contract.

Force majeure provisions in EPC contacts

Engineering, Procurement and Construction ("**EPC**") contracts typically include a provision that excuses the contractor from performing the contract following the occurrence of certain events outside the control of the affected party, often referred to as '*force majeure*'. The effect of the *force majeure* clause will depend on the specific language used in the provision and on the governing law of the EPC contract. If the affected party is the contractor, it will generally be relieved of liability for 'liquidated damages' for any resulting delay. Some EPC contracts treat the cost consequences as neutral (which may be favoured by the project company and its lenders), whilst others entitle the contractor to recover costs as a result of such events.

Although the 2017 FIDIC Conditions of Contract for Plant and Design-Build (Yellow Book) did not retain the *force majeure* clause from the 1999 version, Clause 18.1 "Exceptional Event" essentially reflects the definition of an event or circumstance that is (i) beyond a party's control, (ii) that the party could not reasonably have provided against before entering into the contract; (iii) having arisen, that such party could not reasonably have avoided or overcome, and (iv) not substantially attributable to the other party. Notably, the Exceptional Event clause does not specifically list outbreaks of communicable diseases or pandemics as 'exceptional events' that would give rise to an extension of time or costs recovery. Parties may try to argue that the outbreak falls within one of the examples listed, such as 'natural catastrophes', however this is uncertain.

Parties may also rely upon Article 13.6 "Adjustments for Changes in Laws" to claim that governmental control measures and policies which hinder the construction work from being completed amount to a change of law, and therefore contractors are entitled to recover their increased costs.

Impact on Chinese contractors in overseas construction projects

There are a number of practical aspects that may face Chinese contractors in respect of overseas construction projects.

Overseas project developers and employers, because of local restrictions in response to the epidemic, may directly or implicitly exclude Chinese companies from participating bids for certain projects, or simply suspend or reduce cooperation with Chinese companies on construction projects.

Chinese contractors may also become less competitive when they are required to be on site for inspection, negotiation or attending bidding processes due to travel bans or visa restrictions. The increasing difficulties of having sufficient construction personnel on site and clearing customs for equipment and materials from China will add additional time and cost to the project. These factors can be significant when an international employer considers choosing a contractor to undertake a project.

For ongoing construction projects, the impacts may be more direct: (1) more stringent quarantine measures imposed by the customs authorities of the host country with regard to equipment and construction materials imported from China will affect the timely entry and increased cost of

customs clearance; (2) restricted visa and limited work permits issued to Chinese employees will delay construction progress on the ground; (3) the overseas employer may instruct that the general contractor should not choose Chinese subcontractors or Chinese supply companies for the project; and (4) the domestic Chinese manufacturing company may fail to deliver supplies on time as stipulated in the contract and further face claims for damages by the overseas clients.

It is possible that the overseas employer may assert that Chinese contractors can avoid a delay in performance under the contract by engaging local or foreign construction personnel to complete the construction as an alternative, and therefore the impediment (*force majeure*) relied upon by the Chinese contractors should not be approved by the court.

In this regard, we recommend that Chinese contractors and supply companies, when submitting a *force majeure* claim, shall provide a full and detailed analysis particularly in relation to the specific impact on the project. If necessary, Chinese companies may seek an official proof from China Council for the Promotion of International Trade ("**CCPIT**"), which announced on 30 January 2020 that it can issue a statement to applicants certifying the existence of *force majeure* facts.

Recommendations for Chinese contractors of overseas construction projects

In the meantime, we recommend that where Chinese companies are involved in an EPC project or overseas construction project, they should consider taking the following actions.

1. Pay close attention to the control measures implemented by the host country, evaluate and adjust implementation plans promptly based on the local situation.

For ongoing projects, although the contractors may be excused liability on the basis of *force majeure*, they should actively look for alternatives to avoid the delay as much as they can. Potential alternatives can be seeking a temporary local workforce as a replacement to continue the construction work, outsourcing or further subcontracting work to local or third-country companies, looking for alternative sources of supply, and adjusting the work sequence of the project, etc. If approval from the employer for amendments is required under the contract, the contractor should obtain written consent from the employer prior to any changes and keep good written records of the change.

For new projects contracted around or after the outbreak of the Coronavirus, contractors should take the likely effects of the virus into consideration when calculating the costs, timescale, and labor required for the project, as under these circumstances contractors will no longer be able to claim *force majeure* to be excused of their obligations. Chinese contractors with limited resources may want to consider joint cooperation with local or third country firms when bidding for projects.

2. Engage in timely and effective communication with the employer

Doing so will assist to avoid misunderstandings that may influence the host country to impose more stringent restrictions on Chinese companies and suppliers. Chinese contractors may consider approaching the local Chinese embassy to facilitate dialogue.

3. Initiate appropriate and timely *force majeure* notices and claims

EPC contracts generally stipulate that contractors should issue notices to employers within a certain period of time after they have been made aware of the *force majeure* event. Not issuing a notice may be treated as a waiver of rights. For example, FIDIC Conditions of Contract for EPC/Turnkey Projects (Silver Book) requires that notice of *force majeure* should be sent to employers within 14 days, notices of triggering events of claims should be made within 28 days, and detailed claim reports should be submitted to employers within 42 days from the occurrence

of the triggering event. Contractors are also expected to provide supporting documents along with each notice submission to substantiate its proposition.

4. Take necessary mitigation measures and increase EHS management capability

As discussed above, in order for the *force majeure* to be applicable, contractors need to take necessary mitigation measures to minimise loss. This means that contractors cannot simply suspend work without seeking alternatives even though they encounter problems with getting sufficient labour, visas and supply or customs clearance of materials.

Contractors are also highly recommended to follow the local Environment, Health and Safety ("**EHS**") rules, regulations and standard specifications. It is vital that Chinese companies cooperate with local health and quarantine bureaus to implement quarantine and screening measures and properly address EHS-related concerns and suggestions raised by those managing the construction project in accordance with local labour law and policy.

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